CONSTITUTIONAL RESTRICTIONS ON MUNICIPAL DEBT

This paper is concerned with a criticism of the present constitutional restrictions on municipal[1] indebtedness in the United States. These restrictions may be summarized as follows:

First: Municipalities generally are forbidden to subsidize private capital. There are many exceptions to this rule, however, of which Wisconsin and Iowa may be cited as examples. The states having constitutions adopted more recently, as, for instance, Wyoming, South Dakota, North Dakota, Oklahoma, New Mexico, and Arizona, all prohibit such subsidies.

Second: The amount of debt which may be contracted is generally limited to a definite percentage of the assessed value of property within the districts in question.

Third: A maximum period of years is usually named in the constitutions beyond which debts are not allowed to run.

Fourth: A referendum vote is required for the contraction of long-time or bonded debt.

Fifth: A direct tax is required to be levied at the time the bonded debt is incurred, and at each succeeding year thereafter to pay the interest as it accrues and the principal at maturity.

Sixth: Money borrowed for certain purposes is not counted in computing the constitutional indebtedness.

Seventh: A definite limit extended beyond the ordinary one is frequently allowed for certain classes of debt which are supposed to carry with them no financial burden because of the revenue-bearing capacity of the properties for which the money is used.

Let us discuss these various constitutional limitations as to their purpose and adequacy.

Municipal corporations are in essence of a twofold character. From one point of view they are administrative units, in so far as they are agents of the state; from another point of view they are

[1] The term municipality is here used to include all the minor political units of the states, such as counties, towns, cities, school districts, drainage districts, etc.

business units, in so far as they are created to provide local necessities and conveniences. The former characteristic is illustrated by the county units which are created primarily to aid the state in administering justice, in promoting education, etc. They have a direct and almost exclusive reference to the general policy of the state, and serve as agents through which this policy may be carried out. The latter characteristic is illustrated in street-paving, in drain and sewer construction, in sewage disposal, and in the general business functions of cities. Thus, while a city is an arm of the state, in the administration of law, for instance, it is, at the same time, and is becoming more and more so, a business unit through which its stockholders—the public—are served. From this point of view a city should be regarded as subject to many of the same laws of finance as a private corporation. The same standards of service must be furnished, and, *ceteris paribus*, at the same cost to the consumers. Capital must be supplied and replaced when worn out, extensions and improvements made, depreciation provided for, and the properties kept up as producing units. What cities need from the state is power to carry on local government; what they should do is in large measure to be determined by those alone concerned acting in the capacity of a corporate unit. The responsibilities of effecting a desired end should rest with the appropriate officials, and the execution of the policies determined be according to approved business and economic principles. The accepted functions of political units constantly change, and the regulations governing their activities must be formulated in the light of this fact. A hard-and-fast, an a priori philosophy of the relations of the state to its minor units, as well as of the relations of the latter to commercial and industrial enterprises, is bound to be archaic almost as soon as it is formulated. State control over local finance is necessary—the patrimony of both is in large measure identical. But to be effective, it must be dynamic and elastic, and these qualities our present constitutional restrictions do not possess.

There are no valid objections to the constitutional prohibitions, now almost universal among the states, against municipalities lending their credit to and subscribing to the stock of private corporations. The era of timidity and scarcity of private capital is passed,

and subsidies in the form of public aid are no longer necessary to attract and promote legitimate private enterprises. The market for private securities, through the perfection of exchanges, is now so vast and the supply of capital so responsive to the demand that requisite funds are readily collected for enterprises of distinct benefit to industrial growth or supremacy. Such restrictions, being essentially a matter of policy, and requiring no technical or extended definition, and not involving questions of technique and administrative excellence, may conveniently be placed in the fundamental law as settled for an indefinite period. Conditions calling for a reversal of public opinion will not frequently arise, and if they do, the changes demanded may likewise be incorporated in the constitutions. The other restrictions require extended and detailed treatment.

Municipal credit ultimately rests upon the taxing power. Resources of municipalities, except for the few properties which are revenue-bearing, lie in the value of private property subject to taxation. Taxes become a first lien upon this value, and it is to this that the creditor looks for the satisfaction of his claims. But values for tax purposes, in the United States, are *assessed* values—a certain percentage of the capitalized market value—and, to guard against undue taxation, constitution-makers have expressed the amount of debt permissible to a municipality as a certain percentage of this assessed value. The determining consideration in fixing the debt limit has been the amount of debt and not the need or desirability of a policy of deficit financiering. But these two aspects of this question, although confused even today in our latest constitutions, are nevertheless quite dissimilar, and should be discussed separately.

The general property tax is distinctively American, and was common among the states at an early date. This tax, although possessed of some points of value, when properties are simple and tangible, is now discredited and generally considered a failure. With its weaknesses as a system of taxation we are not concerned, but the difficulties involved in its assessment are pertinent to our inquiry. These, when approached from the point of view of public borrowing, present new and interesting problems.

Constitutional restrictions based upon the assessed value of property are imposed to prevent public credit from being abused. But if property is under-assessed, the use of credit, even when a policy of deficit financiering is justified, is prevented, in proportion to the degree of under-assessment and despite the fact that the debt limit, measured in terms of actual property value, in reality has not been reached. Limitations on the use of debt must serve, among other purposes, (1) to prevent undue or extortionate taxation, and (2) to express the relative proportions in which tax burdens should be divided between the present and the future taxpayers. The total burden which taxpayers must bear will approximately be equal from one tax period to another, but the proportions in which it is divided, as between current revenues and debt obligations, must of necessity vary with each change of policy adopted and with each new project undertaken. To make the borrowing power a certain percentage of the assessed value of property answers only half of the problem, and this part in an unscientific manner. Borrowing is a necessary financial device for public corporations to employ. It is liable to abuse, however, and needs to be regulated, but regulation must not be made dependent upon the willingness or ability of local assessors to evaluate property correctly or uniformly.

The difficulties involved in such a scheme of regulation, in so far as the assessment of property—the measure of permissible debt—is concerned, are excellently illustrated in the experience of cities and other local divisions in Wisconsin and other states. The constitution of Wisconsin gives counties the privilege to borrow to the extent of 5 per cent of their assessed value, according to the last preceding assessment for state and county purposes. Supposing this limit to be reasonable, let us see to what extent its effectiveness is negatived by the assessment of the general property tax of the state. The average ratio of assessed to true value of property in Richland County for the five years ending 1909 was 48.36 per cent. The similar ratios for the same period for the adjoining counties, viz., Vernon, Crawford, Sauk, Iowa, and Grant, were, respectively, 55.18 per cent, 51.34 per cent, 53.79 per cent, 51.00 per cent, and 65.14 per cent; that is, the borrowing power computed in terms of borrowing capacity—true value—was

from 3 per cent to 17 per cent higher for the last-named counties than for Richland. The variations of the ratios of assessed to true value for all the counties of the state, 1905–9 inclusive, are indicated by the following frequency classification:[1]

Number of Counties	Ratio of Assessed to True Value Per Cent
2	30.00 to 39.99
17	40.00 to 49.99
32	50.00 to 59.99
14	60.00 to 69.99
6	70.00 to 79.99

Interpreted in terms of power to borrow, these results give the counties with an assessed value of 70.00 to 79.99 per cent of their true value practically double the borrowing power of those with assessed values from 40.00 to 49.99 per cent. The question is not whether counties should borrow 5 per cent or nothing at all; it is whether assessed value of property is a satisfactory basis upon which to measure borrowing capacity.

The same sort of analysis may be extended to cities in Wisconsin. The constitution gives to the cities a 5 per cent borrowing power and bases it upon the assessed value of property within their limits. The average ratio of assessed to true value of the property in Washburn City, Bayfield County, for the five-year period 1905–9 inclusive, was 97.72 per cent. The corresponding percentage for Beaver Dam City, Dodge County, was 44.72 per cent. The chief cities in Dodge County, for the same period, show the following percentages of assessed to true value of property: Beaver Dam, 44.72 per cent; Waupun, 68.21 per cent; Mayville, 44.62 per cent; Horicon, 63.16 per cent; Juneau, 55.92 per cent; and Watertown (the part in Dodge County), 50.39 per cent. These figures are probably more nearly uniform and nearer to true value than are the corresponding figures in most other states, yet they forcibly prove that assessed value of property is an imperfect basis upon which to compute borrowing capacity.

Inasmuch as this measure is common among the states, let us still extend our analysis to cities outside of Wisconsin. Table I

[1] These figures were compiled from the records of the Wisconsin State Tax Commission, and were arrived at on the basis of bona fide sales.

shows the ratios of assessed to true value of real property in the 158 cities of the United States with populations over 30,000 in 1908. This table indicates that the same variations in the assessment are found in the larger cities—cities where the use of borrowed funds is absolutely necessary and where there is constant effort to expand the limit. Sometimes resort is had to constitutional amendment. The recent experience of New York

TABLE I

SHOWING THE RATIOS OF ASSESSED TO TRUE VALUE OF REAL PROPERTY IN CITIES OF THE UNITED STATES WITH POPULATION OVER 30,000 IN 1908

RATIO OF ASSESSED TO TRUE VALUE PER CENT	TOTAL		NUMBER OF CITIES HAVING POPULATION			
	Number	Distribution Per Cent	Over 300,000	100,000 to 300,000	50,000 to 100,000	30,000 to 50,000
15 to 19.99	4	2.53	1	1	.....	2
20 to 24.99	4	2.53	.....	.....	2	2
25 to 29.99	2	1.27	.....	.....	1	1
30 to 34.99	1	0.63	.....	.....	.....	1
35 to 39.99	3	1.90	.....	1	2	.....
40 to 44.99	6	3.80	.....	2	2	2
45 to 49.99	2	1.27	.....	.....	2	.....
50 to 54.99	15	9.50	2	3	2	8
55 to 59.99	4	2.53	.....	.....	.....	4
60 to 64.99	19	12.02	3	6	3	7
65 to 69.99	15	9.50	1	1	4	9
70 to 74.99	7	4.43	.....	2	2	3
75 to 79.99	10	6.33	2	1	4	3
80 to 84.99	12	7.59	1	4	4	3
85 to 89.99	2	1.27	.....	1	.....	1
90 to 94.99	3	1.90	.....	.....	1	2
95 to 99.99	2	1.27	.....	1	1	.....
100	47	29.73	6	7	17	17
Total	158	100.00	16	30	47	65

City is a case in point. Often the courts are appealed to, to hold that this or that is outside the legal limit. Even out-and-out evasion is not considered bad taste when circumstances seem to warrant, and when the political ring is in command. Chicago furnishes an excellent example of the effect of the assessment of property upon the amount of debt that may be contracted. The legal debt limit is 5 per cent of the assessed value of property. But property is assessed at about 15 per cent of its true value, and notwithstanding this city has half of the population of New York,

it has but "one-eleventh of the gross indebtedness and about one-fifteenth of its assessed value. . . . ."[1] The smallness of the debt of the city of Chicago is directly attributable to the "extremely low assessment."[2]

Under-assessment and variation in assessment are common to all tax jurisdictions.[3] The iniquities of the general property tax are extended to the domain of public borrowing, and discrimination between localities similarly situated, with similar needs and with equal ability to satisfy them, is thus inevitable. Control and regulation are conditioned upon the success or failure of our local tax officials in the assessment of a tax no longer suited to our complex industrial life and our varied classes of properties. Such a scheme of control is not only unscientific but absolutely indefensible. It permits an increase in the amount of debt and a decrease in the proportion of taxes by the simple device of increasing the assessed value and lowering the tax rate. Such a thing is more than speculation. It has been practiced time and time again.[4] But even if it should never be resorted to the possibility of so doing and the incentive to do so are always present. Thus, the *raison d'être* of regulation—the guaranty of equality between the present and the future taxpayers—is completely negatived.

[1] D. F. Wilcox, *Schriften des Vereins für Socialpolitik*, CXXIII, 176.

[2] D. F. Wilcox, *The American City*, p. 393.

[3] The ratios of assessed to true value for 472 cities, towns, villages, and school districts, chosen at random from all parts of the United States, are as follows:

Ratio of Assessed to True Value Per Cent	No. of Instances	Ratio of Assessed to True Value Per Cent	No. of Instances
0–19.99	3	60–64.99	68
20–24.99	0	65–69.99	48
25–29.99	24	70–74.99	10
30–34.99	55	75–79.99	64
35–39.99	10	80–84.99	21
40–44.99	29	85–89.99	2
45–49.99	0	90–94.99	14
50–54.99	78	95–99.99	0
55–59.99	1	100–over	45

These data were collected from the *Commercial and Financial Chronicle, State and City Supplement*, 1909.

[4] See references to the practice in New York City in 1903, and in Philadelphia, a year or two later, in *State and Local Taxation*, Second International Conference, 1909, p. 537. See also E. P. Allinson and Boise Penrose, *Philadelphia: A History of Municipal Development* (Philadelphia, 1888), pp. 276–77.

Moreover, this scheme of regulation presupposes that the *needs* of a city, town, county, or other municipal corporation for borrowed funds are proportional to the value of property. This is not necessarily true. An increase in the value of city property is due, primarily, to growth in population, to improvements made, to the perfection of industrial processes, and to the competition for advantageous situations, etc. But the *need* of a particular locality for borrowed funds may be due to the failure of private initiative to satisfy collective wants, to a desire to increase the general welfare by methods the expense of which cannot and ought not to be added to the tax rate, to certain effects of the complexity of social conditions, to the age of the community, to the enterprise shown in making improvements, etc., causes any one or all of which may have nothing directly to do with the increased value of property. Increase in the value of property does indicate ability to bear tax burdens, but it does not explain the *amount* of burden which should be borne by the present generation by current tax levy, or by future generations in the form of long-term indebtedness. The amount of funds acquired by the use of public credit is related to the value of property, but only indirectly. The direct relationship is between this and the total contribution, and it is this fact which is lost sight of in any scheme which relates debt solely to the assessed value of property.

It would certainly be wrong to contend that the amount of public debt incurred bears no relation to the value of property. To the public creditor debt is almost solely related to it, since, in most communities, the only source of public credit is taxable wealth. But to say that the necessary regulation of public borrowing is accomplished when debt equivalent to a certain percentage of the value of taxable property is allowed, is equally incorrect. Borrowing involves far more than the *amount* of debt. To the taxpayer it involves the purpose of debt, payment of debt, equalization of burdens between the present and the future, economical and efficient use of the amounts borrowed, etc. The amount must be reasonable and suited to the economic and political needs of the public corporation employing it. Like taxes, since both are levies upon private income, it must find its justification in the

results arising out of its utilization. What is demanded is a reasonable return for a given outlay; and the financial means best adapted, when all interests are considered, should receive the support of the taxpayer.

Another important objection may be made to the assessed value of property as an adequate basis upon which to compute debt. In the assessment of property for the purposes of taxation, that owned by public corporations is not placed upon the tax rolls, and so we have the interesting anomaly of corporations with the most property having the least borrowing power. But, it is said, the major part of such property is non-revenue-bearing, and cannot, therefore, support public credit; and that debt contracted for revenue-bearing properties is, in most constitutions, outside of the debt limit. This is conceded, but concerning the latter phase of the contention more will be said later on. The foundation of credit in public economy is the taxing power. Taxes in the United States are computed upon the assessed valuation of property, but the real source of credit—the willingness to endure taxation—has little relation to this assessing expedient. The assessment can be low, high, or indifferently made, and this of itself have little connection with the people's willingness to contribute. The point insisted upon is that the willingness to pay taxes and to support credit is antecedent and the method of acquiring the contribution subsequent. But the constitutional requirements consider only private property. The value attached to public property is ignored because it is non-revenue-bearing, even though its existence does indicate an ability and a willingness to pay, and therefore does support credit.

Indeed, property such as public buildings, bridges, street improvements, sewerage plants, parks, etc., although they yield no net return and are a heavy drain upon the taxes, are precisely the things which, as works of utility, convenience, and ornamentation, add to the value of private holdings, and serve as additional security upon which credit may rest.[1] One would hardly claim that the presence of 212 parcels of land and other property, includ-

[1] See Maurice Muhleman, "Municipal Bonds and Municipal Credit," *Bankers' Law Journal*, August, 1911, p. 642.

ing churches, schools, hospitals, lodges, etc., with an approximate value of $3,000,000,[1] together with the university grounds and buildings, all of which are tax exempt, do not materially affect the credit of Madison, Wisconsin, as a borrowing unit. And yet all these factors, so vital in the determination of the rate of interest at which municipalities can borrow, are totally ignored by the requirement which bases debt solely upon the assessed value of property.

Instances are not unheard of where city property has been sold to satisfy debt obligation. It represents an accumulated fund, and one upon which a city can realize in the case of approaching bankruptcy. Property shows an ability to pay; the taxes levied and the permanent properties acquired as a result of expenditure are evidences of a willingness to pay, and it is the latter which supports credit because taxes are levied by those who actually make the contributions. This is not a tremendously important matter, in the smaller cities, because the value of municipal properties, except in comparatively few instances, would not, if added to the assessment of private property, materially affect their borrowing power. The point is mentioned in this connection only because it seems fundamentally unsound to make borrowing power for public corporations inversely proportional to the value of property owned, while in private corporations, with which public corporations are often brought into competition, and by the standards of which municipal enterprise is often judged, borrowing is, other things being equal, directly proportional to property.

When municipalities are viewed as administrative areas alone, as aids in carrying out a central policy, it is conceivable that some definite limit should be placed on the amount of income that should be devoted to public uses. But when they are viewed as corporations created to insure to their members the conveniences and necessities of local government it is submitted that there is no standard except that of results which shows the amount of private income that should be diverted into public channels. The end is always the most economic satisfaction of wants. Some wants are public, others are private, and the shifting of them from the one

[1] Madison City Assessor in the *Wisconsin State Journal*, Madison, January 18, 1911.

category to the other makes difficult any a priori determination of the amounts to be appropriated by taxation or acquired by borrowing. The amount of debt that a community should incur is not an arbitrary percentage of an ill-defined assessment, but that part of the total burden the people are willing to shoulder which justly and economically cannot be assimilated to the taxing machinery. There is no danger in debt, *per se*—the danger lies in the failure to pay debt. And here again the constitutional limitations are open to criticism. This leads to a consideration of the time which a public debt should be allowed to run.

The justification of incurring long-time indebtedness is to equalize the burden of public expenditure between the present and the future taxpayer. Some expenditures are necessary from which the chief benefits are realized in the future, or which endure through a period of time, and it is only just that those who receive the benefits should bear the expense. This equalization can be effected by making the duration of loans approximately equivalent to the life of the properties acquired. That debts should be paid is recognized in the maturing periods placed in our constitutions. But unfortunately the laws which provide for the use of the borrowing power far too frequently extend the periods to the maxima named in the constitutions. These periods are almost always taken advantage of by city officials, who, through inexperience in handling loans, or through choice, put off the day of settlement as long as possible. Milwaukee, Wisconsin, issues all her bonds for 20-year periods, and among such issues are Bath bonds, Bridge bonds, Viaduct bonds, City Hall bonds, Docking and Dredging bonds, Emergency Hospital bonds, Fire Department bonds, Park bonds, Refunding bonds, etc.[1] St. Paul, Minnesota, with an outstanding debt of $9,040,000 on January 1, 1909, showed 82 distinct issues of bonds, all running 30 years. Among these were Workhouse bonds, Building bonds, Park bonds, Macadamizing bonds, Court House bonds, Sewer Connection bonds, etc.[2] Of the 130 different cities of the United States with population over 30,000 in 1908, which issued bonds in that year, the average period in 16 cities was less than 10 years; in 65 cities, 10 to 22 years; in 36

[1] *Annual Report of the City Comptroller*, 1909, pp. 28 ff.

[2] *Annual Report of the City Comptroller*, January 1, 1909.

cities, 22 to 31 years; and in 13 cities, 31 to 51 years. But 16 per cent of all the periods were between 10 and 13 years; 18 per cent between 19 and 22 years; and 19 per cent between 28 and 31 years.[1] So long as the duration of loans is pushed to the limit set in the constitution, or allowed to concentrate upon the even numbers, as 10, 20, and 30 years; and so long as half of the outstanding debt of our 158 largest cities matures after a period of 20 years, there is no evidence of any conscious attempt to suit the period of debt payment to the life of properties acquired. Again, the constitutional restriction fails to indicate the proper solution of this phase of public debt.

The problems involved in the determination of the proper periods for debt contracts are economic, and each demands specific attention. This is not a question of policy suitable for constitutional statement. There is no general rule that *all* debts should be paid within a specified number of years. Debts should be *paid.* This is an accepted canon of public finance; *when* they should be paid can be determined only after an analysis of the life or utility of each property, and after general social policy and the most approved experience in the solution of such problems have been given due consideration.

The constitutional requirement that a direct annual tax be levied at the time a loan is made, and each year thereafter, sufficient to pay the interest as it accrues and the principal at maturity, is common to constitutional municipal debt limits. This measure of safety is to insure against perpetual debt, and to serve as a protection for future taxpayers. Time was when public credit was based upon the accumulation and continuance of such a fund. Now, however, public credit almost invariably rests upon the taxing power, and the actual presence of sinking funds plays little or no part in its determination. The constitutional and legislative requirements that these be *provided* do not insure their *maintenance.* An annual tax may be levied in good faith, but a *fund* may never materialize. Indeed, today, if a fund is accumulated, it does not serve as a guaranty against further taxation for the purpose for which it is accumulated, but rather is uniformly considered by the

[1] *Statistics of Cities with Population over 30,000 in 1908,* Washington, D.C.; data taken from Table XXXVI.

courts as an offset to debt obligation, in the determination of constitutional indebtedness, thereby extending the debt limit by the amount accumulated. One thing is certain, the taxpayer frequently finds little protection in the accumulation of such "funds."

Many important questions are involved in overlapping political jurisdictions borrowing under general blanket provisions of the state constitutions. Ordinarily these documents extend to all independent political corporations the power to borrow money. Thus, the amount of indebtedness which a particular people may be called upon to endure depends wholly upon the disposition of the legislatures to create such units. Nebraska and South Carolina limit the total amount of debt that may be incurred by such overlapping jurisdictions. It is surprising that so many of the constitutions confuse the *fiction* of independent corporations with the *facts* of local finance. The device so artfully conceived of in the period of state and municipal aid to railroads, whereby the people in one capacity assumed responsibilities and expenses which they refused in another, is still being operated under our latest constitutions. There is no reason why all political units should not be accorded the privilege of borrowing money if there is sufficient justification for its use, but there is likewise no reason why all corporations should enjoy this privilege to an almost unlimited and uncontrolled extent, merely because they happened to be termed by the legislatures "independent."[1] If the purposes for which a corporation within a city, for instance, wishes to borrow are municipal, there are no economic reasons why the debt should not be termed municipal and be charged to the service of government in that district. Many, if not the majority of the so-called "independent" corporations are purely administrative districts created either to carry out the policies of states or to subdivide the functions and expedite the administrations of cities.[2] The debts incurred fall upon the taxpayers generally and the burdens they

[1] See James M. Gray, *Limitations of the Taxing Power*, p. 1110, for a statement of the rulings of the court in this matter.

[2] The following independent districts having borrowing power are found in cities of the United States with population over 30,000 in 1908: School districts in 72 cities; Park districts in 5 cities; Sanitary districts in 2 cities; Poor district in 1 city; Bridge district in 1 city; Water district in 1 city; and District for Police in 1 city (*Statistics of Cities with Population over 30,000 in 1908*, p. 22).

impose should be charged against the taxpayers whether residing in corporations independent or otherwise. But the courts do not so interpret these provisions.[1] "Without wholly denying the legislative power in the creation of subordinate governmental agencies,"[2] it would be impossible for the courts to arrest the evils arising from the conflict of jurisdictions. Nor should they be called upon to formulate and enforce a correct principle. The difficulties lie in the failure of constitution-makers to square political philosophy with actual facts. Borrowing power ought not to come to every political corporation as by birthright. It need not accompany the taxing power at all. When it is conferred, however, it should be adequate to the purposes at hand. Whether a particular service is done by one administrative unit or by another is important only in so far as economy and efficiency are involved. Under the present constitutional limitations what is or is not local debt must always remain indefinite because the distinction is affected by a mass of uncertainties and by dissimilar laws, and its determination depends in large part upon the attitude of the courts in deciding the legal questions involved.

There is another grave defect in our present constitutional restrictions on local indebtedness. Certain forms of debt, as loans made in anticipation of taxes to be collected, and debt for certain specified purposes, as for providing water, sewage disposal, etc., are often omitted from the legal limit. Let us consider these practices in the order named.

The purpose of temporary indebtedness, or temporary loans, is to bridge over the period from one tax collection to another.

[1] In *Wilson* v. *Board of Trustees*, 27 N.E. Rep. 203, a sanitary district is allowed independent borrowing powers under Art. IX, sec. 12, of the constitution of Illinois. In *Wilson* v. *The Board of Education, et al.*, 81 N.W. Rep. 952 (S.D.), a city debt is not counted in the determination of a debt limit of a school district, although the district is wholly within the limits of the city. Conversely, in *Vallelly* v. *Board of Park Commissioners*, 111 N.W. Rep. 615 (N.D.), 1907, school district indebtedness is not counted in the determination of the debt of the city, although the city wholly includes the district. See also *National Life Insurance Company* v. *Mead*, 133 S.D. 37; *Kennebec Water District* v. *City of Waterville*, 52 Atl. Rep. 774, 1902; see also the interesting interpretation of the New York constitution in 32 N.E. 622. Other cases bearing on this general question are: *Todd* v. *City of Laurens*, 26 S.E. 682, S.C., 1897; *Wilcoxen* v. *City of Bluffton*, 54 N.E. 110, Ind.; *Board of Education* v. *Bitting*, 9 N.M. 588.

[2] Gray, *op. cit.*, p. 1110.

Expenditure is a continuous process; taxes are collected ordinarily but once a year, and the income and outgo of money cannot readily be adjusted to each other. Temporary loans, therefore, are resorted to.[1] They are frequently justified on the ground that it is cheaper to borrow for current expenditure during the year, and to pay the amount contracted at the end of the year out of taxes, than to deposit the taxes in banks with interest at the current rate, because the interest received will be less than the value of the taxes to the taxpayers during the year.[2] Such loans, because theoretically offset by taxes to be collected, are ordinarily not computed in determining constitutional debts. Taxes are offset, for the moment, as it were, but these loans represent in most municipalities a constantly recurring item, the interest of which is not offset[3] but operates with the same pressure as do the interest charges on funded debt. If the purposes of debt restrictions are only to prohibit the deferment of taxes, then temporary loans may be computed as outside of the debt limit, providing they are paid at maturity and are not issued in amounts exceeding the revenues actually collected and against which they are issued.[4] But if their purpose is to protect the taxpayer against undue and burdensome taxation, then temporary loans are clearly within the debt limit, for the oppression lies in the permanent interest charge which they entail, and this of course must be made up from the taxes collected.

New York City is completely converted to the use of temporary loans, prefers them to any scheme involving half-yearly or quarterly

[1] How far a city may anticipate its taxes so as to expend them in advance of their collection is often before the court. The taxes must have been actually "levied," *Law et al.* v. *The People ex rel.*, 87 Ill. 385, 399; also *Fenton* v. *Blair*, 11 Utah 78. On the general question see *Bankers' Magazine* (New York), XXX, 946. On the practice in New York City of indulging in temporary loans, see *Annals of the American Academy*, Vol. LXI (1912), in which Mr. William A. Prendergast, city comptroller, criticizes the old method and outlines the present plan followed in collecting adequate funds to tide the city over from one tax collection period to the next.

[2] *New York Advisory Commission on Taxation and Finance*, 1908, pp. 34–35, Lawson Purdy, secretary.

[3] Concerning the interest on such loans in Massachusetts see *Statistics of Municipal Finances*, 1907, p. xxvi.

[4] See *Report of the New York Advisory Commission on Taxation and Finance*, 1908, for an account of the practice of New York at that time in making such loans in excess of the taxes collected.

tax payments, and issued during January, February, March, April, May, 1910, the following amounts respectively: $12,223,325; $18,323,600; $9,343,000; $21,396,440, and $31,828,231.[1] Of the total gross outstanding debt of the 158 largest cities of the United States in 1908, 9.3 per cent was for temporary loans, revenue loans, and outstanding warrants.[2] In the 33 cities in Massachusetts with population over 5,000 in 1907, the proportion of temporary loans to total outstanding debt of all kinds constituted 3.7 per cent; while of the total interest payments for all debt the proportion occasioned by temporary loans constituted 6.1 per cent. In the case of the 65 towns of the same state with population over 5,000 in the same year, the proportion of temporary loans to total outstanding debt of all kinds constituted 8.1 per cent; while of the total interest payments, the proportion for temporary loans equaled 12.5 per cent.[3] These figures show that the interest payments for temporary loans for cities and towns of Massachusetts form one-eighth to one-sixteenth of the total. Of what significance is the fact that 91.8 per cent of the loans incurred by the towns of the above state, and 92.1 per cent of the loans incurred by the cities of the same state are paid during the year, if, as soon as canceled, they are again negotiated? The principal appears and disappears, but the interest is a continuous item and it is this which constitutes the drain upon the taxpayer. Even in the field of temporary debt there are many problems which call for careful consideration in spite of the present constitutional restrictions and limitations.

It was noted above, for further discussion, that it is usual to count as outside the constitutional debt limit debts for purposes which are ostensibly revenue-bearing. Surrounded by the safeguards specified in the constitutions of New York[4] and

[1] *Commercial and Financial Chronicle*, XC, 126, 392, 649, 1000, 1255, 1508.

[2] *Statistics of Cities with Population over 30,000 in 1908*, p. 244.

[3] *Statistics of Municipal Finances*, 1907, pp. 62, 65, 186, 191.

[4] Indebtedness contracted for the following purposes falls outside of the constitutional debt limit: "For a public improvement owned or to be owned by the city which yields to the city current net revenue, after making any necessary allowances for repairs and maintenance, for which the city is liable in excess of the interest on said debt and of the annual instalments necessary for its amortization, may be excluded in ascertaining the power of said city to become otherwise indebted, provided

Virginia,[1] some of the objections to this practice lose their weight. The objectionable thing consists in allowing a municipality to omit this debt from the constitutional limit and at the same time sell its bonds upon the security of the taxing power. True, the debt to be thus omitted in the cases of New York and Virginia must be paid from the revenues realized, but whether success or failure attends the venture the creditor has the taxing power to fall back upon. If the utility or service supplied is of such a nature as legitimately to make the debt contracted for it not a burden upon the taxes, consistency would demand that the debt be guaranteed by the properties themselves, or their earning power. The creditor is fully protected, but the debtor, the taxpayer as distinct from the consumer, may be imposed upon in case of failure, for the debt is still the legal obligation of the municipality.

Our general conclusions may be summarized as follows:

1. The prohibitions against municipalities lending their credit to or subscribing to the stock of private corporations seems justified, and might well be made universal and absolute.

2. The assessed value of property as a basis upon which to gauge the amount of debt that is permissible for municipalities to incur

that a sinking fund for its amortization shall have been established and maintained and that the indebtedness shall not be so excluded during any period of time when the revenue aforesaid shall not be sufficient to equal the said interest and amortization instalments, and except further that any indebtedness heretofore incurred by the city of New York for any rapid transit or dock investments may be so excluded proportionally to the extent to which the current net revenue received by said city therefrom shall meet the interest and amortization instalments therefor, provided that any increase in the debt-incurring power of the city of New York which shall result from the exclusion of debts heretofore incurred shall be available only for the acquisition or construction of properties to be used for rapid transit or dock purposes."—*Constitution of New York*, 1894, as amended 1909, Art. VIII, sec. 10.

[1] The provision of the Virginia constitution declares that the exemption from the debt limit shall apply only so long as the municipal plants for supplying water, etc., succeed in producing sufficient revenue to pay the cost of operation and administration, "including interest on bonds issued therefor, and the cost of insurance against loss by injury to persons or property, and an annual amount to be covered into a sinking fund sufficient to pay, at or before maturity, all bonds issued on account of said undertaking," and all "bonds outstanding shall be included in determining the limitation of the power to incur indebtedness unless the principal and interest thereof be made payable exclusively from the receipts of the undertaking."—*Constitution of Virginia*, 1902, sec. 127*b*.

is open to criticism (*a*) because the assessment of property is imperfectly made, thus allowing discrimination between political units similarly situated and similarly able to borrow; (*b*) because borrowing may be and is indulged in too freely by increasing the assessment, and taxes used too sparingly by lowering the tax rate; (*c*) because such regulations make the *need* for borrowed funds proportional to the value of property; and (*d*) because no account is taken of valuable city properties not found on the tax rolls, which nevertheless actively support public credit.

3. In fixing the borrowing power of municipalities at a stated percentage of the assessed value of property, a proper definite ratio of public to private income is presupposed, and the constantly increasing public needs are therefore not provided for without a constant revision of the percentage. Constitutional amendments are difficult to get, and even when secured they meet only the needs of a particular time and place and are unsuited for general application.

4. The possibility of issuing bonds to run the maximum periods named in the constitutions is eagerly taken advantage of, and as a result much of the debt issued violates the canon of taxation which requires that the burdens of taxation be as equitably distributed between the present and the future taxpayers as the nature of the services growing out of their utilization will admit.

5. The grant of borrowing privileges to all independent corporations necessarily results in an overlapping of tax areas, and in an undue extension of debt.

6. The omission of temporary loans from the debt limit seems unwarranted, as does also the omission of debt for certain purposes supposed to be revenue-bearing, when the bonds issued therefor are secured by the general taxing power rather than by the properties themselves or their earning capacity.

While the constitutional restrictions on local indebtedness are open to severe criticism, they are by no means devoid of some virtues. They were imposed for the most part in a time of undue speculation and abuse of public credit, and at least had the salutary effect of protecting many municipalities from bankruptcy. But the causes which produced them in the main no longer exist, and

there are only the slightest chances of their recurring. Some of the causes of abuse still remain, such as the corruption that attends municipal administration, but these have endured in spite of the restrictions. Municipal debt has grown under the restrictions, and will continue to grow. City life and development are dependent upon its utilization, and its legitimacy as a companion to direct taxation is acknowledged by all. Grants of aid to private capital are rapidly being supplanted by expenditures involving competition with private capital in furnishing service. The question, therefore, is how borrowing can be utilized legitimately, and expenditures of public funds regulated adequately, so as to guarantee a maximum of service for a given outlay, and not, how local debt can be most effectively suppressed by rigid constitutional restrictions. The question at base is administrative and not constitutional.

HORACE SECRIST

NORTHWESTERN UNIVERSITY